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**Research Update:**

# Italcementi And Subsidiary Ciments Français Downgraded To 'BBB', Off Watch Neg; Outlook Stable

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## Rationale

On May 16, 2008, Standard & Poor's Ratings Services lowered its long-term corporate credit ratings on Italcementi, the world's fifth-largest cement manufacturer, and its 79%-owned subsidiary Ciments Français S.A., to 'BBB' from 'BBB+'. The outlook is stable.

At the same time, all the ratings were removed from CreditWatch with negative implications, where they had been placed on Feb. 1, 2008. The 'A-2' short-term rating was also affirmed.

The downgrade follows a combination of worse-than expected-drops in Italcementi's performance in Italy and the U.S. and very aggressive debt leverage at its Italian operations. Together, these factors translate into weaker-than-anticipated credit metrics. We believe that the structural industry challenges and sharp economic deceleration currently seen in Italy, together with overall steady investments, will prevent any significant rebound in performance over the next two to three years. The recent investigations of Italcementi's subsidiary Calcestruzzi have had no significant impact on Italcementi so far, but we will closely monitor any future legal or economic ramifications. Although Ciments Français' stand-alone creditworthiness continues to be much stronger than that of Italcementi, the ratings on the French subsidiary are capped by those on its parent.

The ratings reflect the group's solid market positions, large scale, broad geographic diversity, and healthy cash flow generation. Constraints are the group's moderate financial policy, heavy capital spending, weak margins in Italy, and exposure to cyclical end-markets and continuously soaring energy prices.

With €6 billion in revenues in 2007, the group has strong positions in Italy and France (which together account for about one-half of revenues), as well as in several high-margin areas around the Mediterranean, the northeastern U.S., and a number of Asian countries. After industry-wide record results posted in 2006, the group's performances weakened in 2007, and first-quarter 2008 saw a 3% organic decline in revenues. Near-term volume prospects are negative in mature areas, but still healthy in most emerging markets, which accounted for roughly 40% of EBITDA last year. Steady price increases continue to be passed across the geographic portfolio, cushioning the adverse impact of weaker volumes in mature markets and cost inflation. Despite the unfolding cyclical downturn in several markets, we believe the group will continue to generate robust cash flows, underpinned by its solid positions, overall healthy EBITDA margins, near the mid-20 percent mark, and cost streamlining.

Funds from operations (FFO) should therefore cover a large part of future

growth capital spending, but we think that Italcementi's hefty investments will prevent any recovery in credit metrics in the next three years. In addition to capital spending on efficiency and new capacities, we anticipate regular, albeit more moderate, acquisitions given the group's active participation in industry consolidation and strategic targeting of an increased presence in Middle Eastern and Mediterranean markets. We do not expect a one-off buyout of Ciments Français' minority interests, but we expect steady purchases of free float stock.

### Short-term credit factors

The short-term rating is 'A-2'. Liquidity continues to be solid, underpinned by structurally ample, committed, and undrawn bank lines. Italcementi has €2.4 billion in essentially multiyear lines, comprising €550 million lines at parent Italcementi SpA and €1.8 billion at Ciments Français S.A. (including a €700 million syndicated facility due in 2012). This largely covers total short-term debt of €648 million, as well as the next few years' maturities, which are in the €100 million-€200 million range over 2009-2012 at Ciments Français, minimal at Italcementi SpA in 2009-2010 and in the €200 million-€300 million range in 2011-2012. When present, debt covenants provide ample headroom, and there are no rating triggers. In addition, the group's flexibility is further supported by robust cash flow generation, although this will be absorbed by heavy discretionary capital expenditures in the coming years, and very good access to debt markets.

The net cash situation and the relatively liquid and diversified portfolio of the family-owned holding company Italmobiliare provide Italcementi with potential flexibility on dividend payments, and offset limitations that family shareholding structures typically have on access to new equity.

## Outlook

The stable outlook reflects our expectation that the adjusted ratio of FFO to debt will hover close to 30% on a consolidated level. The group's solid positioning, large scale, and broad diversity should underpin continuous, solid cash generation, despite cost pressures and cyclical end-markets. Ratings downside could come from aggressive debt-funded acquisitions. In this high-fixed-costs industry, severe price disruptions in key markets can also severely impair cash flows, but at this stage we expect firm pricing in most of the group's markets. Still, the impact of considerable capacity additions foreseen in emerging economies will need close monitoring in about five years.

## Ratings List

	To	From
Italcementi		
Corporate credit rating		

BBB/Stable/A-2                      BBB+/Watch Neg/A-2

Ciments Français S.A.

Corporate credit rating

BBB/Stable/A-2                      BBB+/Watch Neg/A-2

Senior unsecured debt

BBB                                      BBB+/Watch Neg

Commercial paper

A-2                                        A-2/Watch Neg

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